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RUEHUJA/AMEMBASSY ABUJA 1956
RUEHAR/AMEMBASSY ACCRA 1967
RUEHDS/AMEMBASSY ADDIS ABABA 2089
RUEHBY/AMEMBASSY CANBERRA 1366
RUEHDK/AMEMBASSY DAKAR 1723
RUEHKM/AMEMBASSY KAMPALA 2145
RUEHNR/AMEMBASSY NAIROBI 4576
RUEAIIA/CIA WASHDC
RUEHGV/USMISSION GENEVA 1228
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHDC//DHO-7//
RUCPDOC/DEPT OF COMMERCE WASHDC
RUZEJAA/JAC MOLESWORTH RAF MOLESWORTH UK//DOOC/ECMO/CC/DAO/DOB/DOI//
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C O N F I D E N T I A L SECTION 01 OF 03 HARARE 000416

SIPDIS

AF/S FOR S. HILL
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR L.DOBBINS AND E.LOKEN
TREASURY FOR D. PETERS AND T.RAND
COMMERCE FOR BECKY ERKUL
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: DECL: 05/09/2018
TAGS: ECON EFIN PGOV ZI
SUBJECT: LIBERALIZED FOREX TRADING, PLUS MORE PATCHES FROM
RBZ GOVERNOR GONO

REF: HARARE 0138

Classified By: Ambassador James D. McGee for reason 1.4 (d)

SUMMARY

¶1. (SBU) Against the background of an ever worsening economic crisis, Reserve Bank of Zimbabwe (RBZ) Governor Gono announced his Monetary Policy Statement (MPS) for the first quarter of 2008 on April 30. The objectives of the MPS are noble, but the measures are more of the same, with the exception of the partial liberalization of the foreign exchange market. Gono expanded quasi-fiscal activities as a way of trying to engineer a quick supply side response, even though these measures have been disappointing until now. In the final analysis, money supply growth is likely to continue breaking new records with the consequent increase in inflation, which is approaching one million percent. Without fundamental and mutually reinforcing reforms, the economy is likely to shrink further. END SUMMARY.

Gono Partially Liberalizes Foreign Exchange Market

¶2. (SBU) In his Monetary Policy Statement of April 30, 2008, RBZ Governor Gono announced partial liberalization of the foreign exchange market as a means of generating desperately needed hard currency. Authorized dealers may now match sellers and buyers of foreign exchange at a price determined by the interplay of supply and demand. The RBZ, however, drew up a priority list of imports to guide the purchase of foreign exchange. Food production related goods head the

list, followed by fuel, electricity, and industrial inputs. While all private transactions are to occur at the inter-bank rate, the GOZ will continue to exchange at Z$30,000:US$1. (NOTE: The average inter-bank rate on May 6 was about Z$160 million:US$ and fell to about Z$210 million:US$ within days. To alleviate a growing cash shortage, the RBZ also introduced new Z$100 million and Z$250 million notes on May 5. The highest denominated note had been the Z$50 million note, which the RBZ released in early April, 2008. END NOTE.)

¶3. (SBU) Along with ordinary Zimbabweans, embassies, NGOs and Zimbabweans in the diaspora can now exchange their hard currency with any authorized dealer. In a briefing to diplomats on May 2, Gono advised that modalities were being finalized for the foreign currency accounts of NGOs to no longer be centralized at the RBZ. While conceding that exporters and NGOs had experienced delays in accessing their foreign currency, Gono expressed confidence that forex availability would soon improve. In the meantime, companies that were owed foreign currency could opt to obtain local currency from the RBZ at the inter-bank exchange rate, or, in the case of exporters, they could deduct foreign exchange from their surrender requirement to the RBZ.

More Flexible Forex Surrender Requirement

¶4. (SBU) Gono also announced a new foreign exchange surrender threshold for exporters based on incremental export values.

The measure appears to be a way of trying to engineer a quick supply side response, even though such measures have produced disappointing results up until now. The scale slides from a surrender requirement to the RBZ of 20 percent if a company's exports are growing by 15 percent, to as little as 2.5 percent for a growth rate in exports of 35 percent and above. The scale takes export figures from March 2008 as a base. Funds surrendered will be priced at the inter-bank rate. The rest of the export earnings will be held in Foreign Currency Accounts for up to 21 days after which it will be sold into the inter-bank pool and on-sold to priority foreign currency users. (NOTE: We know of numerous companies that succeeded in the past year in negotiating the surrender of zero to 10 percent of their forex earnings to the RBZ. END NOTE.)

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Interest Rates Hiked in Bid to Dampen Inflation
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¶5. (SBU) In a move designed to control inflation arising from high credit expansion, the RBZ also raised its secured and unsecured overnight accommodation rates from 4,000 percent and 4,500 percent to 4,500 percent and 5,000 percent respectively.

No Let-Up In Quasi-Fiscal Activity

¶6. (SBU) Despite the RBZ's plan in January 2008 (reftel) to reduce its quasi-fiscal activity, Gono extended both the Basic Commodities Supply Side Intervention (BACOSSI) and the Agricultural Sector Productivity Enhancement Facility (ASPEF). He introduced minor modifications to these deeply subsidized facilities (25 percent interest per annum) in an attempt to reduce abuse. For example, to stop beneficiaries of BACOSSI from diverting the funds to other activities, the terms now specify production targets and timeframes. In addition, funding will now be disbursed on a reimbursement basis calculated against actual output delivered, rather than up front. In the same vein, ASPEF funding will be contingent on documentation of past farming performance as well as evidence that the applicant has reinvested income in the farm. Gono also announced the start in July of phase 4 of

the farm mechanization program.

¶7. (SBU) The Governor conceded the distortionary effects of price controls by introducing a Z$300 trillion Strategic Products Price Controls Mitigation Fund. Under this facility, producers of strategic products can apply for funds to compensate for the adverse effects of price controls.

Justifying RBZ Intervention

¶8. (SBU) Gono justified his interventionism by selectively citing economic crises and examples of other central banks' intervention around the world. Pointing to the steep rise in world food prices, he made the case that Zimbabwe was not alone in experiencing food shortages and an escalating cost of living. In his view, these circumstances justified intervention in Zimbabwe's agricultural sector. In the same vein, Gono referred to the handling of recent banking crises in the UK and U.S. as evidence of the need for central bank

intervention in the Zimbabwe economy. As usual, he also blamed the state of the economy on "sanctions."

COMMENT

¶9. (SBU) Gono failed to note that Zimbabwe's food shortages predated the current global food problem; they have their root in the haphazard land grabs of 2000 and the government's misguided economic policies of more than a decade. Gono also failed to point out that other central banks' interventions were confined to their mandate to prevent instability in the financial sector, whereas the RBZ has usurped the role of a multitude of government ministries. At the root of the record growth in money supply and, inevitably, Zimbabwe's hyperinflationary environment is the RBZ's own unabated quasi-fiscal activity (i.e. off-budget spending). Given that Gono has now extended and increased this spending, there is little prospect of reigning in hyperinflation, notwithstanding higher interest rates.

¶10. (C) The partial liberalization of the exchange rate is welcome in that it raises the profitability of exports in Zimbabwe dollar terms. However, the establishment of a priority list for purchasing forex is likely to confer economic rents and favor those who determine the priority sectors. Foreign currency is likely to flow to sectors that have lower rates of return than if the market had determined the allocation. Moreover, failure to adjust the official exchange rate implies that the government and the well connected will continue to access foreign exchange at an immensely subsidized price and derive huge economic rents from this distortion. Given hyperinflation (PriceWaterhouseCoopers' closely-held monthly inflation report put the year-on-year rate in April at one million percent for high-income earners), the rate of depreciation required to maintain export competitiveness may frighten policy makers into reversing the measures that promote exports, as the costs of depreciation are usually front-loaded while the benefits appear later.

¶11. (SBU) In the final analysis, Zimbabwe needs to implement mutually reinforcing reforms. Where distortions are pervasive, the removal of one while keeping the others intact is unlikely to improve welfare. In this regard, this Monetary Policy Statement is one more in a series that only pokes fingers in the dyke. END COMMENT.

MCGEE